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No. 06-870

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IN THE

Supreme Court of the United States

CROWN PAPER LIQUIDATING TRUST,

Petitioner,

v.

PRICEWATERHOUSE COOPERS, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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PARTIES TO THE PROCEEDING AND STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Respondents note the following misstatement in Petitioner's Rule 14.1(b) statement: Fort James Corporation, Fort James Operating Company, Fort James Fiber Company, and Fort James International Holdings (the "Fort James entities") were not parties to the Ninth Circuit's judgment, review of which is sought through the Petition. The Fort James entities are parties to a separate action that remains pending in the District Court. *Crown Paper Co., et al. v. Fort James Corp., et al.*, N.D. Cal. No. C 02-3839 MMC.

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INTRODUCTION

The Petition challenges the dismissal of state law claims brought by the bankruptcy trustee for two now-defunct entities, Crown Paper Company and Crown Vantage, Inc. ("Crown"). The United States District Court for the Northern District of California held the claims barred under state law by the defense of *in pari delicto*, and the Ninth Circuit affirmed for the reasons stated by the District Court. The sole question presented is whether Section 541(a)(1) of the Bankruptcy Code, which includes in the "property" of a bankruptcy estate "all legal or equitable interests of the debtor in property as of the commencement of the case," means that state law causes of action that become property of the estate are subject to defenses that would have barred the claim as of the time the case commenced. All eight Circuits that have considered this question, including the Ninth Circuit below, have answered it in the affirmative, and that result is consistent with longstanding precedent of this Court. Because there is no conflict among the circuits or with this Court's prior cases on the sole federal question presented, and because the policy arguments raised in the Petition go solely to issues of state law, or, at most, constitute an unwarranted request for federal common law of the sort specifically rejected in *O'Melveny & Myers* v. *FDIC*, 512 U.S. 79 (1994), the Petition does not present any issue that warrants review by this Court. Indeed the Court has denied at least two petitions raising the same question. *See Laddin* v. *Reliance Trust Co.*, 127 S. Ct. 45 (2006); *Terlecky* v. *Hurd*, 525 U.S. 812 (1998).

STATEMENT OF THE CASE

Petitioner's complaint challenges a 1995 transaction in which James River Corporation "spun off" certain business operations to its shareholders. The resulting Crown entities operated for five years and then filed for bankruptcy protection in March 2000. In November 2001, the bankruptcy court confirmed Crown's Liquidating Plan, under which Petitioner was appointed trustee and thereby succeeded to the interests of Crown in the property of the Crown estate, as defined in Section 541(a)(1) of the Bankruptcy Code. The Plan instructed the trustee expeditiously to liquidate the property that had been the Crown estate.

Petitioner filed this action in California state court, asserting solely state law claims held by Crown against four financial firms, two accounting firms, a law firm, and certain individual former officers and directors of James River and Crown. The complaint alleged that these defendants – Respondents here – assisted or conspired with James River in the planning or execution of the spin-off and/or its subsequent concealment and thereby defrauded Crown under various state law theories. Respondents removed the action, under 28 U.S.C. § 1452(a), to the United States District Court for the Northern District of California.

In two separate orders, the District Court held that all of Petitioner's claims were barred by the state law defense of *in pari delicto*. Pet. App. B-C. The District Court first held that, under 11 U.S.C. § 541(a)(1), a bankruptcy trustee is subject to the same state law defenses that would be available against the debtor as of the commencement of the case. The court specifically noted that "every Circuit to have considered the question," including in the context of *in pari delicto*

defenses, has reached the same conclusion. Pet. App. 18a. The court then held that the *in pari delicto* defense was established under applicable Virginia law by Petitioner's own allegations that Crown's senior officers and directors, and its sole shareholder, were aware of and actively participated in the alleged wrongdoing. *Id.* at 18a-20a; *see also id.* at 57a-58a. The District Court denied Petitioner's motion for reconsideration, and the Ninth Circuit, after oral argument, issued a one-sentence order affirming the judgment "for the reasons set forth in the well-reasoned district court orders." *Id.* at 4a. Petitioner's requests to the Ninth Circuit for rehearing and rehearing *en banc* were denied, *id.* at 72a, and this Petition followed.

REASONS FOR DENYING THE PETITION

1. *There is no circuit split on the sole federal question presented.*

The Petition identifies no conflict among the lower courts on any issue of federal law. Both Petitioner's claims and the defenses thereto arose under state law, and the only federal question is one on which all of the Courts of Appeals to consider the issue agree: specifically, whether a trustee who brings state law claims on behalf of the debtor under Section 541 of the Bankruptcy Code is subject to state law defenses that would have applied to the debtor as of the commencement of the case. The trustee is charged with collecting the property of the estate, a term that Section 541(a)(1) defines to include "all legal or equitable interests of the debtor in property as of the commencement of the case." Under longstanding precedent of this Court, the debtor's interests in property, absent a controlling federal rule, are defined and limited by applicable state law.

Nobelman v. *American Savings Bank*, 508 U.S. 324 (1993); *Butner* v. *United States*, 440 U.S. 48, 54-55 (1979). This Court also has held, under the predecessor statute to Section 541(a), that state law causes of action brought by the trustee on behalf of the debtor are subject to the same limitations and defenses that would have applied to the debtor as of the time the case commenced; the trustee in such cases "succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankruptcy but for the filing of the petition." *Bank of Marin* v. *England*, 385 U.S. 99, 101 (1966) (construing Section 70a of the former Bankruptcy Act).

Every Circuit to consider the question – specifically, the First, Second, Third, Sixth, Eighth, Ninth, Tenth, and Eleventh – has interpreted Section 541(a)(1) in the same way, *i.e.*, to mean that a bankruptcy trustee pursuing state law claims on behalf of the debtor is subject to the same state law defenses as would have applied to the debtor, including *in pari delicto* defenses based on the debtor's wrongful conduct. *See, e.g.*, *Nisselson* v. *Lernout*, 469 F.3d 143, 153 (1st Cir. 2006); *In re Mediators, Inc.*, 105 F.3d 822, 825-26 (2d Cir. 1997); *Official Comm. of Unsecured Creditors* v. *R.F. Lafferty & Co.*, 267 F.3d 340, 355-58, (3d Cir. 2001); *In re Dublin Sec., Inc.*, 133 F.3d 377, 380 (6th Cir. 1997), *cert. denied*, 525 U.S. 812 (1998); *Grassmueck* v. *Am. Shorthorn Ass'n*, 402 F.3d 833, 836 (8th Cir. 2005); *In re Hedged-Invs. Assocs., Inc.*, 84 F.3d 1281, 1285 (10th Cir. 1996); *Official Comm. of Unsecured Creditors of PSA, Inc.* v. *Edwards*, 437 F.3d 1145, 1150-52 (11th Cir. 2006), *cert. denied*, 127 S. Ct. 45 (2006). Courts have acknowledged the unanimity on this issue. *See, e.g.*, Pet. App. 18a ("[E]very Circuit to have considered the question has held that *in pari delicto* can be asserted against a trustee."); *Edwards*, 437 F.3d at 1151 ("[O]ur

sister circuits that have considered the issue have unanimously concluded that *in pari delicto* applies with equal force to a trustee-in-bankruptcy as a debtor outside of bankruptcy.").

Unable to point to a circuit conflict, the Petition attempts to frame a conflict with district and bankruptcy court decisions. Petitioner's lead case is *In re Fuzion Technologies Group, Inc.*, 332 B.R. 225 (Bankr. S.D. Fla. 2005), where the bankruptcy court, despite 11 U.S.C. § 541, held that a debtor's state law claim was exempt from an otherwise-applicable *in pari delicto* defense because it was being pursued by a bankruptcy trustee rather than by the debtor. That decision, however, no longer is good law even in the district in which it was issued, in light of the Eleventh Circuit's subsequent decision in *Edwards* explicitly rejecting precisely that view.[1] *See* 437 F.3d at 1149-52. Petitioner identifies two other district court cases that decline to apply the *in pari delicto* defense to a trustee – *In re Jack Greenberg, Inc.*, 240 B.R. 486 (E.D. Pa. 1999) and *Welt* v. *Sirmans*, 3 F. Supp. 2d 1396 (S.D. Fla. 1997) – but both cases address the issue solely under state law, *Greenberg*, 240 B.R. at 501; *Welt*, 3 F. Supp. 2d at 1401-03, and also have been rendered obsolete by contrary decisions of their respective courts of appeals. *R.F. Lafferty*, 267 F.3d at 355-58; *Edwards*, 437 F.3d at 1150.

In a footnote, Petitioner suggests an intra-circuit conflict between the Ninth Circuit's decision below and its prior decision in *FDIC* v. *O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995), on remand from this Court's decision in

[1] The academic arguments cited in *Fuzion*, 332 B.R. at 230 n.2, and also cited in the Petition at 14-15 & n.4., have been rejected by every other court to consider them. *See In re Greater Se. Cmty. Hosp. Corp. I*, 353 B.R. 324, 363 n.61 (Bankr. D.D.C. 2006) (collecting cases).

O'Melveny & Myers v. FDIC, 512 U.S. 79 (1994). But even if discord within a circuit were of concern to this Court, no conflict exists there either, because *O'Melveny* involved a receiver and not a trustee acting under 11 U.S.C. § 541, as the District Court held here, and as several courts of appeals have noted. Pet. App. 19a-20a; *see also, e.g., R.F. Lafferty*, 267 F.3d at 358 (*O'Melveny* is "easily distinguishable" because "receivers are not subject to the limits of section 541"). Moreover, the Ninth Circuit's decision on remand in *O'Melveny* was based expressly on California law. 61 F.3d at 19. Petitioner's reliance on *Scholes* v. *Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995), fails for the same reasons. *See R.F. Lafferty*, 267 F.3d at 358; *see also Edwards*, 437 F.3d at 1151 (dismissing *Scholes* because a bankruptcy trustee is "governed by the Bankruptcy Code, not the law of receiverships").

2. *The decision below correctly interprets the statute and is consistent with this Court's precedent.*

Not only have the courts of appeals interpreted Section 541 consistently; they have done so correctly. The text of Section 541 cannot plausibly be read to preempt the state law defense of *in pari delicto* for claims brought by trustees. The statute clearly states that the interests of the estate shall include "all legal or equitable interests of the debtor in property as of the commencement of the case," 11 U.S.C. § 541(a)(1), and Section 704, in turn, directs the trustee in a liquidation to "collect and reduce to money the property of the estate," 11 U.S.C. § 704(1).[2] Under a straightforward reading of these provisions, state law causes

[2] In the present case, the trustee's duty to liquidate the assets of the former Crown estate and reduce them to money is set out in the Liquidating Plan.

of action, which are a form of interest in property (*see Logan* v. *Zimmerman Brush Co.*, 455 U.S. 422, 432 (1982)), are subject to state law limitations, including laws defining the claims and defenses that existed at the time of the petition. *See Nobelman*, 508 U.S. at 329; *Butner*, 440 U.S. at 54-55. As the Tenth Circuit noted in *Hedged-Investments*, the specific reference in Section 541 to the interests of the debtor in property "as of the commencement of the case" makes clear Congress's intention that the rights of a bankruptcy estate be "no stronger than they were when actually held by the debtor." 84 F.3d at 1285. *See also Edwards*, 437 F.3d at 1150 (Section 541 is "unambiguous"); *R.F. Lafferty*, 267 F.3d at 356 (Section 541 is "explicit" in its direction that defenses be evaluated "as they existed at the commencement of the bankruptcy").

This reading of Section 541 is consistent with longstanding precedent of this Court interpreting the predecessor statute. Former Section 70a of the Bankruptcy Act of 1898, which was replaced in the 1978 Bankruptcy Code with Section 541 and related provisions, vested the trustee "with the title of the bankrupt *as of the date of the filing of the petition initiating a proceeding under this title*" to specified forms of property, including causes of action held by the bankrupt. 52 Stat. 879 (formerly codified at 11 U.S.C. § 110(a)) (repealed 1978) (emphasis added). In *Bank of Marin*, this Court construed Section 70a to mean that the trustee "succeeds only to such rights as the bankrupt possessed" and "is subject to all claims and defenses which might have been asserted against the bankruptcy but for the filing of the petition." 385 U.S. at 101. The holding in *Bank of Marin* followed earlier decisions construing Section 70a. *See Hartman* v. *First Nat'l Bank of Waterloo*, 216 U.S. 134, 138 (1910) (noting that the rule "that the trustee takes the property of the bankrupt, not as an innocent purchaser, but

as the debtor had it at the time of the petition, subject to all valid claims, liens, and equities" is "so well settled that our jurisdiction of the writ of error is exceedingly doubtful"); *Thompson* v. *Fairbanks*, 196 U.S. 516, 526 (1905) (trustee takes property as it was held by the debtor, "subject to all the equities impressed upon it in the hands of the bankrupt").

There is not a word in Section 541, Section 704, or any other provision of the Bankruptcy Code, suggesting that Congress, in enacting Section 541 in place of the prior Section 70a, intended to change the definition of "property of the estate" as construed in *Bank of Marin* and the Court's prior cases – much less to enact the contrary rule that a trustee pursuing state law claims of the debtor must be *relieved* of applicable state law defenses that would interfere with his recovery on the claim. *See In re Ozark Rest. Equip. Co.*, 816 F.2d 1222, 1229-30 (8th Cir. 1987). There was no material change in the operative language – from "as of the date of the filing of the petition initiating a proceeding under this title" under former Section 70a to "as of the commencement of the case" in the present version – and what evidence there is from the legislative record confirms that the 1978 revisions to the Code left the prior definition of "property of the estate," and this Court's interpretation of that provision, intact. *See* H.R. Rep. No. 95-595, pp. 367-68 (1977) (noting that definition in Section 541(a) incorporates all "forms of property currently specified in section 70a;" further noting trustee should "take no greater rights than the debtor himself had"); S. Rep. No. 95-989, p. 82 (1978) (same); *see also R.F. Lafferty*, 267 F.3d at 356; *Hedged-Invs.*, 84 F.3d at 1285; *In re N.S. Garrott & Sons*, 772 F.2d 462, 465-66 (8th Cir. 1985). Although some changes were made in the definition of "property" (primarily to broaden the definition to include exempt property, *see Tignor* v. *Parkinson*, 729 F.2d 977, 980-

81 (4th Cir. 1984)) the essential point that formed the basis for this Court's prior decisions – that property is to be taken as it was in the hands of the debtor at the outset of the case – was explicitly preserved. Not surprisingly, courts addressing the issue under Section 541(a) have relied upon *Bank of Marin* and other precedent construing former Section 70(a). *See R.F. Lafferty*, 267 F.3d at 357; Pet. App. 20a.

The Petition's only statutory response to *Bank of Marin* is that it predated the enactment of 11 U.S.C. § 541(a)(7), which includes in the definition of property of the estate "[a]ny interest in property that the estate acquires after the commencement of the case." But this provision relates solely to after-acquired property, and does nothing to change the limitations placed on property acquired at the *commencement* of the case – the issue presented in this case and covered in Section 541(a)(1) and the Court's prior cases. Petitioner also points to a floor statement by Congressman Edwards, in connection with the 1978 Act, distinguishing between "personal defenses" of the debtor and other defenses. But Congressman Edwards was referring specifically to Section 541(d), which states only that property to which the debtor held legal but not equitable title at the time the case commenced becomes property of the estate only to the extent of the debtor's pre-petition title. The floor statement clarified that "[t]o the extent such an interest is limited in the hands of the debtor;" *i.e.*, is a legal interest only, the estate is not bound by any defenses that could have been asserted against the debtor's person. 124 CONG. REC. H11096 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards). As the Eleventh Circuit noted in *Edwards*, this limitation is unique to Section 541(d), because where the debtor's only right to property is bare legal title, such as to a negotiable instrument, one would not expect a successor holding that negotiable instrument to

be bound by defenses personal to the debtor. *See Edwards*, 437 F.3d at 1150; *see also FDIC v. Wood*, 758 F.2d 156, 160 (6th Cir. 1987) (personal defenses, such as failure of consideration and usury, that stem from the underlying commercial transaction may not be asserted against a negotiable instrument when in the hands of an innocent party). The limitation has no application to Section 541(a)(1), where the trustee succeeds to broader property rights held by the debtor. *Id.*; *see also In re Greater Se. Cmty. Hosp. Corp. I*, 353 B.R. 324, 365-66 (Bankr. D.D.C. 2006).

3. *The Petition fails to establish a conflict between the decision below and this Court's precedents in other areas of the law.*

The Petition next tries to suggest a conflict with this Court's precedent in other areas of the law. There is no need to look to these other cases because there is precedent of this Court directly on point – specifically, *Bank of Marin* and the Court's prior cases holding that a trustee takes claims subject to applicable defenses. But even if that were not the case, the Petition cites only decisions where federal statutory law – specifically, the federal antitrust and securities laws – supplied the underlying cause of action. *See Perma Life Mufflers, Inc.* v. *Int'l Parts Corp.*, 392 U.S. 134, 139 (1968) (antitrust); *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 310 (1985) (securities); *Pinter* v. *Dahl*, 486 U.S. 622 (1988) (same). In construing the federal statutes at issue there, the Court, finding no indication that Congress intended to allow an *in pari delicto* defense, declined to fashion such a defense as a matter of statutory construction or federal common law. *See Perma Life*, 392 U.S. at 139; *Bateman Eichler*, 472 U.S. at 310; *Pinter*, 486 U.S. at 635.

By contrast, the Bankruptcy Code provisions here create neither a federal rule of conduct nor a federal right of recovery, but rather simply direct the trustee to pursue state law property interests as they were held by the debtor at the commencement of the case. *See* 11 U.S.C. § 541(a)(1). Decisions declining to import an *in pari delicto* defense for a federal statutory claim absent an affirmative indication from Congress provide no support for disregarding Congress's intent, as expressed in Section 541, that state law property interests should be unchanged by bankruptcy, including existing state law defenses to state law claims. *See In re Greater Se. Cmty. Hosp.*, 353 B.R. at 363-64 (rejecting analogy between Section 541 and federal antitrust and bankruptcy laws).

4. *The policy arguments raised by Petitioner either relate solely to issues of state law or represent an unwarranted request for federal common law.*

The Petition does not present any federal question of general importance that warrants review by this Court. As discussed above, the sole federal statute at issue, 11 U.S.C. § 541(a)(1), has been interpreted uniformly by every circuit to consider it, and its only effect, by its terms, is to direct inquiries about property interests to applicable state law. Thus, what little federal interest exists in this area is satisfied by a rule that looks to state law as the rule of decision.

The Petition raises a host of policy arguments, primarily to the effect that applying the *in pari delicto* defense to claims brought by bankruptcy trustees interferes with the trustee's role of maximizing the value of the debtor's estate, and has the effect of rewarding wrongdoing on the part of the debtor and its officers. Whatever merit these arguments may have

as a matter of state law or policy, they do not present any federal question properly addressed to this Court.

For the most part, Petitioner's policy arguments raise solely issues of state law because they affect only state law defenses to state law claims. State law was precisely the context in which similar arguments were addressed in the Ninth Circuit's decision on remand in *O'Melveny & Myers*, 61 F.3d at 19 (applying California law), and the Seventh Circuit's decision in *Scholes*, 56 F.3d at 754 (applying Illinois law). And, as the District Court held below, it clearly is state law that governs Petitioner's argument that the *in pari delicto* defense should not apply to claims against corporate "insiders" alleged to have been complicit in the underlying misconduct. Pet. 12-13.[3]

Even as a matter of state law, several courts have refused to accept Petitioner's policy arguments as a basis for displacing *in pari delicto* and related defenses. *See Peregrine Funding, Inc.* v. *Sheppard Mullin Richter & Hampton LLP*, 133 Cal. App. 4th 658 (2005) (no basis under California law to relieve trustee of unclean hands defense); *FDIC* v. *Shrader & York*, 991 F.2d 216, 222-23 (5th Cir. 1993) (declining to

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[3] This specific argument regarding claims against corporate "insiders" was not preserved below. The District Court found that Petitioner waived the argument by failing to raise it during briefing and argument on the motion to dismiss. Resp. App. 3a-4a. The court also found that the argument had no basis in applicable Virginia law. *Id.* Moreover, even under Petitioner's own framework, the "insider" issue is squarely one of state, not federal, law. *See* Pet. at 15 (asserting that the proper question for this Court "is not *how* the *in pari delicto* doctrine should be applied under applicable state law, but rather *whether* the doctrine should be applied to trustees at all – that is a question of federal bankruptcy law") (emphasis Petitioner's).

interpret Texas law to relieve FDIC from state law defenses). But certainly such routine state law questions do not warrant this Court's review. *See Leavitt* v. *Jane L.*, 518 U.S. 137, 144 (1996) (Court normally will not grant a petition for certiorari to review an application of state law).

To the extent that Petitioner is asking this Court to create federal common law as a means of *displacing* applicable state law, this proposition was considered and rejected in *O'Melveny & Myers*, 512 U.S. at 84, 85, 87-89. As an initial matter, the federal common law rule that the Petition seeks – relief for the trustee from state law defenses – directly conflicts with the text of Section 541(a)(1), which defines the trustee's interests as those held by the debtor "as of the commencement of the case." This Court has made clear that federal common law – even in areas where, unlike here, Congress expressly has authorized federal courts to apply general common law principles in interpreting a federal statute – may not be used to alter the substance of an existing federal statute. *See O'Melveny*, 512 U.S. at 85 (Court will not employ federal common law to "contradict an explicit federal statutory provision"); *Mertens* v. *Hewitt Assocs.*, 508 U.S. 248, 257-59 (1993) ("[t]he authority of courts to develop a 'federal common law' under ERISA . . . is not the authority to revise the text of the statute") (citation omitted); *City of Milwaukee* v. *Illinois & Michigan*, 451 U.S. 304, 313-14 (1981) (federal common law improper where Congress has spoken to the question at issue).

Even if there were some ambiguity in the statute, the mere existence of a federal statute permitting the trustee to pursue state law claims would not allow the courts to displace state law with federal common law, as advocated by the trustee; as in *O'Melveny*, such an argument is "demolish[ed]"

by the existence of provisions expressly relieving the trustee of certain provisions of state law for other specific purposes. *See, e.g.*, 11 U.S.C. § 547 (authorizing trustee to void certain transfers as preferences), § 544 (granting trustee the right to pursue claims that otherwise would belong to creditors), § 545 (granting trustee power to avoid certain liens on the debtor's property). As this Court noted in *O'Melveny*, Congress's decision expressly to displace state law only on these discrete points compels the conclusion that state law continues to govern except where a specific provision states otherwise: "Inclusio unius, exclusio alterius." *O'Melveny*, 512 U.S. at 86. *See also Butner*, 440 U.S. at 54-55 & n.9 (apart from specific federal provisions expressly defining trustee's rights in property of the debtor, "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law").

Even if the Petition could overcome the statutory text and this Court's prior precedent, it does not identify any compelling federal interest that would warrant the creation of federal common law. This Court has held that situations warranting federal common law are "few and restricted," *Wheeldin* v. *Wheeler*, 373 U.S. 647, 651 (1963) – limited to instances of "significant conflict between some federal policy or interest and the use of state law." *Wallis* v. *Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966). Such a conflict is essential for the displacement of state law with a federal rule of decision. *See O'Melveny*, 512 U.S. at 87-88. Here, as in *O'Melveny*, the rules of decision at issue do not govern the primary conduct of the United States or its agents, but affect only the trustee's pursuit of private state law rights formerly held by the debtor. Unlike the federal antitrust and securities cases cited in the Petition, this case does not involve any affirmative statutory expression of federal substantive policy.

In fact, the only federal policy expressed by Congress in Section 541(a) is that the courts should look to state law as the rule of decision. In other words, it is federal policy that state substantive law – not federal substantive law – should govern the creation and definition of property interests, and "there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner*, 440 U.S. at 55.

Nor is there any federal policy, as the Petition suggests, to maximize a private bankruptcy estate for the benefit of private creditors or beneficiaries. Although the Bankruptcy Code does give the trustee the important role of collecting the property of the estate and reducing it to money, *see* 11 U.S.C. § 704(1), the very function of the trustee in a case such as this is not to assert his own rights, but rather to act as an advocate for the debtor's property interests – including (as in this case) state law claims subject to state law defenses. *Cf. O'Melveny*, 512 U.S. at 87. There is no federal policy that the trustee "should always win," or that all obstacles to his recovery must be removed. *Id.* at 88.[4] Indeed, there is even less of a federal interest here than there was in *O'Melveny*, because with a bankruptcy estate or trust only private interests (creditors of the debtor, or beneficiaries of the trust) would benefit from the displacement of state

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[4] To the extent there is a federal interest in ensuring that creditors have some means of recovery from alleged wrongdoers, the trustee may pursue claims directly on behalf of creditors under 11 U.S.C. § 544(b); in such cases, the trustee is not bound by state law defenses applicable to the debtor. Indeed, Petitioner's separate action, brought against Fort James (James River's successor) on behalf of Crown's creditors, remains pending in the district court. *Crown Paper Co., et al.* v. *Fort James Corp., et al.*, N.D. Cal. No. C 02-3839 MMC.

law defenses, whereas at least in *O'Melveny* federal insurance funds were at stake. *See id.* at 89. Even in the latter context, this Court in *O'Melveny* expressly rejected "'more money' arguments" of the sort that Petitioner makes here – *i.e.*, the notion that state law defenses must give way to allow the trustee to bring additional funds into the estate. *Id.* at 88. The Court also rejected – as more properly directed to state law – the assertion that state law defenses improperly encourage and/or reward wrongdoing. *Ibid.*

Finally, the so-called "equitable" nature of the bankruptcy courts is an insufficient basis for the creation of federal common law. As this Court noted in *Butner*, "undefined considerations of equity" do not provide a basis for displacing otherwise applicable state law in the definition of the property contained in the debtor's estate. 440 U.S. at 55-56.

CONCLUSION

In sum, the Petition presents no question worthy of review by this Court. The Petition should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX — ORDER DENYING PLAINTIFFS' MOTION FOR LEAVE TO FILE MOTION FOR RECONSIDERATION (N.D. CAL. DEC. 10, 2003)

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

No. 02-3836 MMC

Consolidated Cases

In re:

CROWN VANTAGE, INC.,

Debtor

ORDER DENYING PLAINTIFFS' MOTION FOR LEAVE TO FILE MOTION FOR RECONSIDERATION

(Docket No. 202)

Before the Court is plaintiffs' motion, pursuant to Civil Local Rule 7-9, for leave to file a motion for reconsideration of the Court's September 25, 2003 Order Granting in Part and Denying in Part Defendants' Motions to Dismiss. Defendants have filed opposition thereto.

Civil Local Rule 7-9 provides that "[b]efore entry of a judgment adjudicating all of the claims and the rights and liabilities of all the parties in a case, any party may make a motion before a Judge requesting that the Judge grant the

party leave to file a motion for reconsideration of any interlocutory order made by that Judge on any ground set forth in Civil L.R. 7-9(b)." *See* Civil L.R. 7-9(a). Civil Local Rule Rule 7-9(b) provides: "The moving party must specifically show: (1) That at the time of the motion for leave, a material difference in fact or law exists from that which was presented to the Court before entry of the interlocutory order for which reconsideration is sought. The party also must show that in the exercise of reasonable diligence the party applying for reconsideration did not know such fact or law at the time of the interlocutory order; or (2) The emergence of new material facts or a change in law occurring after the time of such order; or (3) A manifest failure by the Court to consider material facts or dispositive legal arguments which were presented to the Court before such interlocutory order." *See* Civ. L. R. 7-9(b).

Plaintiffs' motion for leave is based on two grounds. First, plaintiffs argue that after they submitted their opposition to defendants' motions to dismiss, two cases addressing "salient issues" were decided, specifically *Breeden v. Kirkpatrick & Lockhart LLP (In re Bennett Funding Group, Inc.)*, 336 F. 3d 94 (2th Cir. 2003) and *Milner v. Beeler (In re Hampton Hotel Investors. L.P.)*, 289 B.R. 563 (Bankr. S.D. N.Y. 2003), and that these cases were "either not discussed at the hearing on the motions to dismiss or were discussed in truncated fashion." (*See* Pls.' Notice of Mot. at iv:7-8, 10-13.) Second, plaintiffs argue that the Court "failed to consider material facts or dispositive legal arguments which were presented to it in the briefs filed by [plaintiffs] or at oral argument on August 15, 2003." (*See* Pls.' Notice of Mot. at iv:8-10.)

Appendix

With respect to plaintiffs' first ground, plaintiffs fail to indicate which of the three subsections set forth in Local Rule 7-9(b) is implicated by plaintiffs' argument. To the extent plaintiffs may be arguing that *Bennett* or *Hampton Hotel* announces a change of law entitling plaintiffs to reconsideration, the Court disagrees. The hearing on defendants' motions to dismiss was conducted on August 15, 2003. Both cases were decided before that date,[1] and plaintiffs make no showing that in the exercise of reasonable diligence, or otherwise, plaintiffs were unaware of these cases. Indeed, defendants cited *Bennett* in their papers filed in support of dismissal, (*see* Supp. Authorities, filed August 8, 2003, Ex. A), and both plaintiffs and defendants cited and relied on *Bennett* at the hearing. *Hampton Hotel* sets forth no change in law. Rather, in the portion of the case cited by plaintiffs, the court quoted from two cases decided, respectively, in 1996 and 1997. *See Hampton Hotel*, 289 B.R. at 577 n. 23 (quoting *Mediators, Inc. v. Manney (In re Mediators)*, 105 F. 3d 822 (2nd Cir. 1997) and *Goldin v. Primavera Familienstiftung, Tag Associates. Ltd. (In re Granite Partners, L.P.)*, 194 B.R. 318 (Bankr. S.D. N.Y. 1996)). Plaintiffs themselves cited one of those cases, *Mediators, Inc. v. Manney*, in their opposition to defendants' motions to dismiss, when arguing that dismissal based on the doctrine of in pari delicto was inappropriate in light of plaintiffs' allegations concerning "innocent" directors. (*See* Pls.' Consolidated Response to Defs.' Mots. to Dismiss at 40:11-41:27.)

In the instant motion, plaintiffs seek to rely on *Mediators* as support for a different legal argument, specifically, that

1. The opinion in *Hampton Hotel* was issued February 28, 2003, and the opinion in *Bennett* was issued July 15, 2003.

the doctrine does not proscribe claims against insiders. That argument, however, could have been raised earlier. Accordingly, plaintiffs have not shown they either were unaware of the applicable law at the time the order issued or that a change in the law occurred thereafter. In any event, the law on which plaintiffs now rely is based on a New York state statute, *see Mediators*, 105 F. 3d at 826-27 (citing N.Y. Bus. Corp. Law § 720), and all parties agree the law applicable to the instant action, with limited exceptions not relevant to the instant motion,[2] is the law of the state of Virginia. Although the Court, in determining the law of Virginia, looked to the common law as discussed in other jurisdictions, including New York, plaintiffs make no showing in their instant motion that the subject New York statute changes the common law as interpreted by the Court. *See id.* (citing § 720; observing "the adverse interest exception does not apply to cases in which the principal is a corporation and the agent is its sole shareholder"); *see, e.g., Diamond v. Diamond*, 107 N.Y.S. 2d 508, 524 (N.Y. Sup. Ct. 1951) (holding corporation, owned by two shareholders, barred under New York law from suing director for diversion of assets where both shareholders assented to diversion), *aff'd*, 120 N.E. 2d 819 (N.Y.1954).[3]

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2. Two defendants have argued that certain claims against them are governed by the law of a state other than New York. Those particular claims arise from conduct occurring after Crown Vantage, Inc., became publicly owned, and, as explained in the Court's order of September 25, 2003, are not barred by the doctrine of in pari delicto. (*See* Order Granting in Part and Denying in Part Defs.' Mots. to Dismiss at 17:16-17:1, n. 15.)

3. Although § 790 had not been enacted at the time *Diamond* was decided, a predecessor statute with substantially the same language was then in effect. *See* Historical and Statutory Notes, N.Y. Bus. Corp. Law § 720.

Appendix

The second ground upon which plaintiffs seek leave to file a motion for reconsideration is the Court's alleged failure to consider the "independent director" allegations contained in plaintiffs' complaint. The Court, however, addressed those allegations at length in its order of September 25, 2003, (*see* Order Granting in Part and Denying in Part Defs.' Mots. to Dismiss at 15:18-17:11), and, consequently, there was no "failure by the Court to consider" plaintiffs' arguments based on those allegations.

Accordingly, plaintiffs' motion for leave to file a motion for reconsideration is hereby DENIED.

This order closes Docket Number 202.

IT IS SO ORDERED.

Dated: DEC 10 2003

s/ Maxine M. Chesney
MAXINE M. CHESNEY
United States District Judge